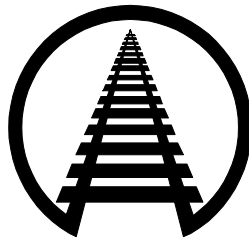


**STATEMENT OF**  
**EDWARD R. HAMBERGER**  
**PRESIDENT & CHIEF EXECUTIVE OFFICER**  
**ASSOCIATION OF AMERICAN RAILROADS**



**BEFORE THE**  
**U.S. HOUSE OF REPRESENTATIVES**  
**COMMITTEE ON TRANSPORTATION AND INFRASTRUCTURE**  
**SUBCOMMITTEE ON RAILROADS**  
  
**HEARING ON**  
**THE RAILROAD RETIREMENT AND SURVIVORS’**  
**IMPROVEMENT ACT OF 2001**

**MAY 10, 2006**

On behalf of the members of the Association of American Railroads (AAR), thank you for the opportunity to discuss the effects of the Railroad Retirement and Survivors' Improvement Act of 2001. AAR members account for the vast majority of freight railroad mileage, employees, and revenue in Canada, Mexico, and the United States.

### Overview of Railroad Retirement

As members of this committee know, the approximately 180,000 employees of U.S. freight railroads — as well as employees of Amtrak, commuter railroads, and rail-related organizations such as rail labor unions and the AAR — are the only significant group of private sector workers in the United States not covered by Social Security. Railroad Retirement provides retirement, disability, and survivor benefits to railroad workers and their families, just as Social Security does for the rest of the work force.

The railroad retirement system has two-tiers. Tier I of Railroad Retirement provides benefits that are largely equivalent to Social Security benefits. Railroad employers and employees pay Tier I taxes that are identical to Social Security payroll taxes. As with Social Security taxes, half of the Tier I tax is paid by the railroad employer and half is paid by the employee.

Tier II of Railroad Retirement provides benefits similar to those of a defined-benefit pension plan. Both employers and employees pay into Tier II, though employers pay a much higher payroll tax rate than employees.

Railroad Retirement also provides benefits to spouses, widows, widowers, and dependent children, and provides disability benefits.<sup>1</sup>

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<sup>1</sup> In addition to Railroad Retirement, railroads often offer 401(k) or other retirement plans to their employees.

## The Railroad Retirement and Survivors' Improvement Act of 2001

Thanks to the wisdom and foresight that members of this committee and others in Congress showed in passing the Railroad Retirement and Survivors' Improvement Act of 2001 ("RRSIA"), hundreds of thousands of railroad employees and retirees can look forward to a better, more secure future. The RRSIA is also a superb example of how rail management and labor can work cooperatively to build a stronger industry.

The RRSIA has several major components:

- *60/30 retirement.* The RRSIA allows 30-year rail employees to retire with full benefits at age 60, rather than age 62 as under previous law. The spouses of such employees are also eligible for full annuities at age 60.
- *Basic service requirement.* The RRSIA lowered the length of creditable service required prior to "vesting" in Railroad Retirement from ten years to five years for post-1995 service.
- *Maximum provision.* The RRSIA eliminated a ceiling on combined monthly employee and spouse benefits that had led to reduced benefits for thousands of employees and spouse annuitants.
- *Widow(er)s' benefits.* The RRSIA established an "initial minimum amount" for widows/widowers equal to 100 percent of an employee's tier II amount, up from 50 percent under prior law. The Railroad Retirement Board estimated that 20 to 25 percent of the widow(er)s on its rolls in 2001 would see an increase in their annuity because of this provision.
- *Investment changes.* Prior to the RRSIA, Railroad Retirement Account assets could be invested only in U.S. government securities — an outdated investment strategy established by the federal government during the Depression, when railroads were failing. The RRSIA modernized the railroad retirement system by allowing Tier II assets to be invested in equities and debt, as well as in government securities. This key change brought the railroad

retirement system in line with nearly every modern pension fund, which can choose between investment options to find the highest return.

Under the RRSIA, railroad retirement assets and authority over investments options were transferred to the National Railroad Retirement Investment Trust (NRRIT), whose Board of Trustees are comprised of three members selected by rail management, three selected by rail labor, and one member selected by a majority of the other six members. All Trustees must have experience and expertise in the management of financial investments and pension plans. The NRRIT is responsible for setting overall investment strategy, and for hiring and/or engaging investment advisors necessary to fulfill the NRRIT’s mission.

- *Supplemental annuities.* The RRSIA eliminated the separate Supplemental Annuity tax under the Railroad Retirement Act, while retaining the supplemental annuity benefit for eligible workers.

### The Goals of the RRSIA Are Being Achieved

A major rationale for investing railroad retirement funds in diversified investments, including equities, was to increase the rate of return of those investments — enhancing the long-term viability of the railroad retirement system even as benefits were increased and tax rates were reduced. This is exactly what has happened.

The RRSIA statutorily reduced the Tier II tax rates on rail employers from the then-existing 16.1 percent in 2001 to 15.6 percent in 2002 to 14.2 percent in 2003 and 13.1 percent in 2004. Since 2004, Tier II tax rates for both employees and employers

Railroad Retirement Payroll Tax Rates				
	Tier I*		Tier II	
	Non-Medicare	Medicare	Employee	Employer
2001	6.20%	1.45%	4.90%	16.10%
2002	6.20%	1.45%	4.90%	15.60%
2003	6.20%	1.45%	4.90%	14.20%
2004	6.20%	1.45%	4.90%	13.10%
2005	6.20%	1.45%	4.40%	12.60%
2006	6.20%	1.45%	4.40%	12.60%
*rate for both employers and employees				

have been adjusted automatically based on the “average account benefits ratio” (AABR), which is the ratio of asset balances to the sum of benefits and administrative expenses. For

any given level of benefits (which are known with a fair degree of certainty from one year to the next), a higher level of assets will yield a higher AABR, and only when the AABR reaches a certain minimum level can Tier II payroll tax rates be further reduced. This way, the retirement funds are fully protected in relation to the payout demand on them.

And, in fact, the diversification of investment options has allowed the value of railroad retirement assets to grow well beyond the value they had when they were transferred to the National Railroad Retirement Investment Trust — just as was intended. At the inception of the NRRIT in February 2002, the value of the trust-managed assets was \$20.7 billion. As of December 31, 2005, the value had risen to \$29.2 billion, an \$8.5 billion increase.<sup>2</sup> This increase allowed the Tier II tax rate to be further reduced. Its current level is 4.40 percent for employees and 12.60 percent for employers.<sup>3</sup>

To be sure, the railroad retirement system remains extremely costly for railroads — far more costly, in fact, than the Social Security system that other private industries, including rail competitors, participate in. Still, the costs of railroad retirement today to rail employers are certainly lower than they would be in the absence of the RRSIA.

These reductions in the payroll tax rate mean more money in the pockets of rail employees and financially stronger railroads. Because of the payroll tax reductions associated with the RRSIA and the elimination of the supplemental annuity assessment, from 2002 through 2005 rail employers in aggregate saved approximately \$1.5 billion.

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<sup>2</sup> The transfer of funds was implemented over an extended period of time, and the diversification of investments is still underway.

<sup>3</sup> The same mechanisms that allow the Tier II payroll tax rates to be reduced if the AABR reaches a certain threshold also mandate that the payroll tax rate be increased if the AABR falls to a certain level. The tax rate on employees can never rise above 4.9 percent (the rate it was when the RRSIA was passed), though the tax rate for employers can rise to 22.1 percent, if necessary. This way, should the investments in the NRRIT lose money or the trust funds fail to keep pace with benefit distributions, railroads — not taxpayers — will be responsible for ensuring the solvency of the system.

For freight railroads, these savings come at an opportune time. Looking ahead, the United States cannot prosper in an increasingly competitive global marketplace if our freight railroads are unable to meet our growing transportation needs, and having adequate railroad capacity is critical in meeting these needs. Railroads must be able to both maintain their extensive existing infrastructure and equipment *and* build the substantial new capacity that will be required to transport the significant additional traffic our economy will generate. This is especially important given the extreme capital intensity of railroading. From 1995 to 2004, the average U.S. manufacturer spent 3.5 percent of revenue on capital expenditures. The comparable figure for U.S. freight railroads was 17.8 percent, or more than five times higher.

If they are to be able to afford the capacity needed to handle this traffic, though, railroads must earn adequate profits. Thanks in part to reduced Tier II payroll tax rates, rail earnings over the past couple of years, while below average within the universe of all industries, have been higher than they have been historically. This welcome development has meant that railroads can more easily justify and afford the massive investments and capacity enhancements that are needed if railroads are to continue to play their proper role in meeting our freight transportation needs.

Indeed, freight rail spending on infrastructure and equipment, which was already substantial, has risen during the four years (2002-2005) RRSIA has been in place, totaling \$5.8 billion more than if the industry's investments had remained at 2001 levels over that period. Moreover, rail spending is expected to rise sharply in future periods. Class I capital expenditures on infrastructure and equipment are expected to exceed \$8 billion in 2006, a level sharply higher than in any prior year.

The efficiencies that have flowed from the RRSIA have been an important enabling factor in allowing the railroads to invest more in capacity enhancements, thereby allowing increased traffic volumes. These greater volumes translate into more trains, and more trains require additional crews. Indeed, rail industry employment has increased in recent years for the first time in some 60 years.

In addition to helping to induce higher employment levels by reducing railroad operating costs, the benefits of the RRSIA to rail employees have also been substantial. For example, the feature of the RRSIA that allows 30-year rail employees to retire with full benefits

at age 60, rather than age 62 as under previous law, allowed thousands of railroad workers to retire earlier than they would have. In fact, so many workers retired that it increased the rail industry's hiring requirements significantly.



#### **H.R. 5074 — Payments of Railroad Retirement Benefits by the U.S. Treasury**

The rail industry appreciates the Committee on Transportation & Infrastructure's recent efforts in reporting out H.R. 5074, which provides for the continued use of the U.S. Department of the Treasury (Treasury) as the disbursing agent for railroad retirement benefits. As this subcommittee knows, Section 107(e) of the RRSIA calls for a nongovernmental financial institution to replace the Treasury as the disbursing agent. This provision was not part of the original rail labor-rail management agreement in support of the RRSIA, but was instead added to the legislation in 2000 during multi-committee consideration of the bill.

The rail industry supports continued use of the Treasury for several reasons. First, use of the Treasury is significantly less expensive for the Railroad Retirement Board (RRB) — approximately \$800,000 per year compared with an estimated \$2.9 million per year to utilize a nongovernmental disbursing agent.

Second, the RRB’s Inspector General has reported that the use of a nongovernmental disbursing agent would make the collection of mistakenly overpaid benefits more difficult, more costly, and less efficient. The Treasury has the ability to use debt collection tools (*e.g.*, withholding tax refunds) that are not available to the private sector.

Third, unless the Treasury is the disbursing agent, it will be necessary to provide federally-held personal information regarding private individuals on a massive scale to an outside private vendor.

## **Conclusion**

The Railroad Retirement and Survivors’ Improvement Act of 2001 modernized the railroad retirement system by giving the rail industry greater responsibility for financing the system and greater flexibility in investing its assets. Retiree benefits have improved, the tax burden has been reduced, and railroads are on sounder financial footing than they would otherwise have been — and thus better able to make the investments in infrastructure and equipment needed to meet our country’s future transportation needs.

The RRSIA was a “win” all the way around and is a testament to the tireless efforts of many of those in this committee and elsewhere in Congress. Railroads look forward to the opportunity to continue to work with policymakers and with rail labor to devise appropriate solutions to the problems we face.